

Message Text

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ACTION EB-07

INFO OCT-01 ARA-10 ISO-00 TRSE-00 AID-05 CIAE-00 COME-00

FRB-01 INR-07 NSAE-00 USIA-15 XMB-04 OPIC-06 SP-02

CIEP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04

CEA-01 L-03 H-02 PRS-01 PA-02 SEC-01 /100 W

----- 052535

R 241320Z JUL 75

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC 0548

INFO AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

UNCLAS SECTION 1 OF 2 BRASILIA 6134

E.O. 11652: N/A

TAGS: AFIN, BR

SUBJECT: STOCK MARKET ACTIVITY PICKS UP: ANOTHER BOOM/BUST?

1. DURING THE LAST TWO MONTHS THE BRAZILIAN STOCK MARKET HAS SEEN THE HIGHEST TRADING SINCE THE STOCK MARKET BOOM OF 1971. THE RIO EXCHANGE INDEX, WHICH AVERAGED 1975.2 (1965-100) POINTS DURING 1974, HIT THE 4,000 MARK IN EARLY JULY, WITH MOSR OF THE RISE TAKING PLACE DURING MAY AND JUNE. THIS RESURGENCE OF ACTIVITY LED MANY PEOPLE, INCLUDING GOVERNMENT OFFICIALS, TO ASK WHETHER THE MARKET WAS FINALLY REACTING TO GOVERNMENT EFFORTS (INCLUDING THE LATEST MEASURES TO ALLOW THE ENTRANCE OF FOREIGN FUNDS INTO THE MARKET) TO GET IT OUT OF THE DOLDRUMS IT HAD BEEN IN SINCE THE 1971 BUST OR WHETHER IT WAS EXPERIENCING ANOTHER SPECULATIVE WAVE A LA 1971 WITH THE DANGER THAT ANOTHER COLLAPSE WOULD SOON BE COMING. THAT GOVERNMENT OFFICIALS WERE FOLLOWING THIS LATEST UPSWING CLOSELY WAS INDICATED BY THE FACT THAT DURING JUNE FINANCE MINISTER SIMONSEN, ON SEVERAL OCCASIONS, HAD TO ASSURE INVESTORS THAT THE AMRKET WAS BEHAVING IN

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A HEALTHY MANNER AND COMPARISONS WITH THE 1971

EXPERIENCE WERE NOT JUSTIFIED. HOWEVER, AS THE MARKET ASCENDANCY GAINED MOMENTUM, THE MONETARY AUTHORITIES APPARENTLY BECAME CONCERNED ABOUT SPECULATIVE MANEUVERS, ESPECIALLY BY BROKERS. ON JULY 3, THEREFORE, THE CENTRAL BANK ISSUED A CIRCULAR PROHIBITING BROKERS FROM STOCK TRADING FOR THEIR OWN ACCOUNT. THIS MEASURE HAD A VERY DEFINITE COOLING EFFECT ON THE MARKET, ALTHOUGH IT HAS BY NO MEANS SUFFERED A COMPLETE REVERSAL. THE RIO INDEX HAS RECENTLY HOVERED AROUND THE 3,800 MARK.

2. CONGEN RIO AND SAO PAULO HAVE POLLED THE FINANCIAL COMMUNITY IN THEIR RESPECTIVE CITIES ON THEIR INTERPRETATION OF THE LATEST DEVELOPMENTS. FOLLOWING REPORT IS BASED ON THEIR FINDINGS.

3. ACCORDING TO THE SAO PAULO FINANCIAL COMMUNITY, THE FACTORS THAT APPEAR TO HAVE MADE THE RECENT SPURT OF TRADING POSSIBLE WERE MAINLY OF A SPECULATIVE NATURE. THESE FACTORS WERE ABETTED BY BROKERAGE FIRMS WITH SUBSTANTIAL PORTFOLIOS WHO BEGAN HEAVY TRADING IN THE SECOND HALF OF JUNE IN LIGHT OF REPORTS OF EXPECTED LARGE INFLOWS OF FOREIGN CAPITAL AS A RESULT OF THE CENTRAL BANK ANNOUNCEMENT TO PERMIT FOREIGN FUNDS INTO THE MARKET. OTHER LESSER FACTORS THAT INDUCED INVESTORS TO TRADING MORE HEAVILY IN THE STOCK EXCHANGE WERE: THE RELATIVELY LOW YIELD ON LETRAS DE CAMBIO, TERM DEPOSIT CERTIFICATES, AND OTHER TYPES OF COMMERCIAL PAPER; THE VERY HIGH COST OF REAL ESTATE WHICH HAS OUTPACED CONSUMER PURCHASING POWER AND THUS DISCOURAGED INVESTMENT; AND THE COLLAPSE THAT BEGAN LAST YEAR OF THE SO-CALLED "ART MARKET". ALL OF THESE HAD BEEN UNTIL RECENTLY IMPORTANT ALTERNATE CHOICES FOR STOCK MARKET INVESTMENTS. CONTINUED PRESS COVERAGE OF GAINS IN VALUES OF CORPORATE STOCK ON THE EXCHANGE ALSO LED SAVERS INTO PUTTING THEIR MONEY IN MUTUAL FUNDS OR BLUE CHIPS IN THE HOPE OF LARGE AND QUICK PROFITS. SOME OBSERVERS, PERHAPS ERRONEOUSLY, BELIEVE

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THAT THE MARKET HAD BEEN POSITIVELY INFLUENCED FURTHER BY THE ATTRACTIVELY LOW PRICE/EARNINGS RATIO OF MOST STOCKS AND THE ENTRANCE OF DECREE LAW 157 FISCAL INVESTMENT FUNDS. IN FACT, THE SAO PAULO COMMUNITY ARGUED, THE PRICE/EARNINGS RATIOS HAVE BEEN LOW FOR OVER TWO YEARS WITHOUT ATTRACTING INVESTOR ATTENTION AND 157 FUND MONEY WILL ONLY MOVE IN SLOWLY.

4. JOSE KFOURY, SUPERINTENDENT OF THE SAO PAULO STOCK EXCHANGE, DID NOT BELIEVE THAT RESOLUTION 328 (PROHIBITING BROKERS FROM TRADING FOR THEIR OWN ACCOUNT) WOULD HAVE ALONG-LASTING DEPRESSING EFFECT. BOTH HE AND LEADING BROKERS IN SAO PAULO AGREE THAT THE LIQUIDATION OF BROKERS' PORTFOLIOS MIGHT RESULT IN A SLIGHT DECLINE IN THE STOCK MARKET BUT ALL ARE HOPEFUL THAT EVENTUALLY THE UPWARD TREND WILL BE MAINTAINED.

5. ACCORDING TO THE RIO COMMUNITY, THE LATEST SPURT WAS THE RESULT OF SEVERAL FACTORS WHICH HAVE POSITIVELY INFLUENCED THE MARKET: (A) THE RELATIVELY LOW/PRICE/EARNINGS RATION OF A GREAT NUMBER OF STOCKS; (B) HE EXPECTED ENTRANCE OF FOREIGN CAPITAL INTO THE SYSTEM. (ONE BROKER LINKED WITH A LARGE BANKING GROUP SAID THAT THEY ALREADY HAVE FOREIGN FUND COMMITMENTS FOR \$55 MILLION); (C) ANTICIPATION OF LARGE AMOUNTS OF INVESTMENT THROUGH DECREE-LAW 157 FISCAL FUNDS AS OF JULY; (D) EXPECTATIONS OF A DECLINING RATE OF INFLATION CAUSING A SHIFT OF FUNDS FROM SAVINGS ACCOUNTS (CADERNETAS DE POUPANCA) TO THE STOCK MARKET; (E) ANTICIPATION OF NEW CENTRAL BANK REGULATIONS REGARDING THE APPLICATION OF INSURANCE COMPANIES TECHNICAL RESERVES WHICH WOULD FAVOR THE STOCK MARKET.

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INR-07 NSAE-00 USIA-15 TRSE-00 XMB-04 OPIC-06 SP-02

CIEP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-04

CEA-01 L-03 H-02 PRS-01 PA-02 SEC-01 /100 W

----- 052648

R 241320Z JUL 75

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC 0549

INFO AMCONSUL RIO DE JANEIRO

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6. THE PARTICIPATION OF BROKERAGE COMPANIES IN RIO EXCHANGE DAILY TRADING VARIES BETWEEN 3 AND 14 PERCENT, ACCORDING TO THE PRESIDENT OF RIO STOCK EXCHANGE. ALTHOUGH SUCH PARTICIPATION MAY NOT HAVE A LARGE INFLUENCE ON THE MARKET AS A WHOLE, IT CAN HAVE AN IMPORTANT IMPACT ON SPECIFIC ISSUES. HE FELT THAT BROKERS ADDED SOME STEAM TO THE FUNDAMENTAL FACTORS WHICH PUSHED UP THE MARKET BUT THEY COULD NOT ALONE BE RESPONSIBLE FOR THE RECENT SPURT.

7. THE CENTRAL BANK MEASURE PROHIBITING STOCK BROKERAGE COMPANIES FROM MAINTAINING THEIR OWN PORTFOLIOS HAS CAUSED CONCERN AND DISAGREEMENT AMONG RIO BROKERS. ACCORDING TO THE PRESIDENT OF THE EXCHANGE, IF THE CENTRAL BANK WANTED TO PUNISH BROKERAGE COMPANIES ENGAGED IN UNETHICAL PRACTICES, IT COULD HAVE USED ITS AUTHORITY TO SUSPEND INDIVIDUAL FIRMS FROM OPERATING RATHER THAN PUNISHING ALL BROKERS. SOME BROKERS DISAGREE, THEY BELIEVE THAT CREATING A PUBLIC CONTROVERSY OVER THIS ISSUE WILL BE HARMFUL TO THE MARKET, AT LEAST IN THE SHORT RUN. MOREOVER, THE MEASURE IS NOT EXCLUSIONARY SINCE UNCLASSIFIED

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BROKERAGE COMPANIES' DIRECTORS CAN STILL TRADE STOCKS AS PHYSICAL (RATHER THAN JURIDICAL) PERSONS. THEY WILL HAVE, HOWEVER, TO GIVE PREFERENCE TO THEIR CLIENTS.

8. THERE ARE DIFFERENCES OF OPINION ALSO IN THE SAO PAULO FINANCIAL COMMUNITY AS TO WHETHER OR NOT THE UPWARD TREND IN THE STOCK MARKET IS SOLIDLY BASED. ACCORDING TO ONE LEADING BANKER, FOR THE TIME BEING, THE TREND IS STILL A HEALTHY ONE. HE IS AFFRAID, HOWEVER, THAT SHOULD GAINS MOVE VERY RAPIDLY AND BE PLAYED UP BY THE LOCAL PRESS, THEY WOULD INDUCE LESS SOPHISTICATED INVESTORS AND SPECULATORS TO MOVE IN HEAVILY AND PUSH PRICES UPWARD AT A VERY RAPID PACE. EVENTUALLY, THIS COULD BRING ABOUT THE KIND OF BUBBLE WHICH GREW IN 1970 AND BURST IN 1971. EVEN KFOURY ADMITS THAT THE DANGER OF VERY SUBSTANTIAL SPECULATIVE ACTIVITY IS EVER PRESENT, ALTHOUGH HE BELIEVES THAT THE GOVERNMENT, AS A RESULT OF THE 1971 EXPERIENCE, WOULD TAKE MEASURES TO DAMPEN EXCESSIVE SPECULATION WITHOUT CAUSING A SERIOUS DECLINE.

9. IN CONCLUSION, IT IS STILL TOO EARLY TO ASSESS
WHETHER OR NOT THE CURRENT UPWARD TREND WILL CONTINUE
UNCHECKED. OF NOTE PERHAPS IS THE FACT THAT ROUGHLY
50 PERCENT OF ALL STOCK TRADED IN SAO PAULO DURING THE
HEIGHT OF ACTIVITY WERE SHARES OF BANCO DO BRASIL,
PETROBRAS AND VALE DO RIO DOCE. THESE GOVERNMENT-OWNED
OR CONTROLLED CORPORATIONS FOR THE LAST TIME WILL OFFER
VERY HIGH DIVIDENDS AND LARGE STOCK SPLITS, SINCE
NEXT YEAR THIS PROCEDURE WILL BE PROHIBITED BY
DECREE. THUS, TO SOME EXTENT THE HECTIV TRADING
IN THESE STOCKS IS DUE TO INVESTORS' DESIRE TO
BENEFIT FROM LAST TIME YIELDS THAT MAY TOTAL AS
MUCH AS 100 PERCENT. ONCE THE DIVIDENDS AND
STOCK SPLITS ARE ANNOUNCED, IT MAY BE THAT THE
FLURRY OF TRADING IN THESE THREE CORPORATIONS WILL
ABATTE SUBSTANTIALY. NONETHELESS, THE LARGE VOLUME
OF TRADING ON THE SAO PAULO STOCK EXCHANGE HAS BEEN
THE CAUSE OF SOME UNEASINESS IN THE MORE CONSERVATIVE
FINANCIAL CIRCLES.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: n/a
Control Number: n/a
Copy: SINGLE
Draft Date: 24 JUL 1975
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: n/a
Disposition Approved on Date:
Disposition Authority: n/a
Disposition Case Number: n/a
Disposition Comment:
Disposition Date: 01 JAN 1960
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1975BRASIL06134
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: D750255-0836
From: BRASILIA
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1975/newtext/t19750723/aaaaauht.tel
Line Count: 249
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EB
Original Classification: UNCLASSIFIED
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 5
Previous Channel Indicators: n/a
Previous Classification: n/a
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: hartledg
Review Comment: n/a
Review Content Flags:
Review Date: 09 OCT 2003
Review Event:
Review Exemptions: n/a
Review History: RELEASED <09 OCT 2003 by ThomasVJ>; APPROVED <08 JAN 2004 by hartledg>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
06 JUL 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: STOCK MARKET ACTIVITY PICKS UP: ANOTHER BOOM/BUST?
TAGS: AFIN, BR
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 06 JUL 2006